Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:GCD:BIR:TL-N-5022-97
JFDriscoll

date: May 12, 1999
to: District Director, Gulf Coast District
Attn: Ed Emanuel - Examination Branch
Birmingham, AL

from: Associate District Counsel, Gulf Coast District, Birmingham

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subject: [redacted]
EIN: [redacted]
AUDIT CYCLE: TYE's [redacted] and [redacted]
Tax Litigation Advisory Opinion - Analysis of, [redacted] Debt/Equity [redacted]) Offering Involving [redacted] and [redacted]

Pursuant to multiple contacts between Large Case Coordinator Ed Emanuel and John F. Driscoll of this office, this memorandum is intended to formalize the view of this office in regard to the above-captioned matter. It is our view that, based upon the information presently available to us, there does not exist a sufficient factual and/or legal basis to challenge the taxpayer's treatment as debt of the [redacted] Securities offering described above. We have arrived at such conclusion only after directly communicating with various IRS representatives who have been intimately involved with analogous "[redacted]" offerings and after reviewing various recent Chief Counsel National Office guidance memoranda specifically addressing analogous factual scenarios.

Since we understand that the proper treatment of "[redacted]" type factual scenarios have recently been the subject of some substantial controversy within the IRS, since such issue presents relatively sophisticated factual and legal questions, since the issue in the immediate case involves substantial dollars and since the Chief Counsel's National Office has historically exercised substantial influence over such issue, we have prepared the attached draft Memorandum to the Chief Counsel's National Office which requests their general acquiescence in our conclusions in this matter. At this time, we request that you review such draft memorandum for both factual completeness and accuracy and advise this office of any corrections, additions

and/or objections you have in regard to it. As discussed with Mr. Emanuel, we additionally request that we be provided with the original Prospectus that was issued in regard to the relevant "[redacted]" offering (we note that the document available to this office for the purposes of our consideration of this matter was solely the [redacted] Prospectus Supplement) and the relevant loan documents.

In accordance with conversations between Mr. Emanuel and Mr. Driscoll, your prompt review of the attached document will be appreciated. Once you have had an opportunity to review the attached proposed memorandum to our National Office, please promptly advise Mr. Driscoll of such fact and provide him with your comments as to such memorandum. Mr. Driscoll may be reached at (205) 912-5458.

SHUFORD A. TUCKER, JR.
Associate District Counsel

John F. Driscoll

By:
JOHN F. DRISCOLL
Senior Attorney

Attachment:
As stated

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:GCD:BIR:TL-N-5022-97
JFDriscoll

date:

to: Assistant Chief Counsel (Financial Institutions and Products)
CC:DOM:FI&P

from: Associate District Counsel, Gulf Coast District, Birmingham

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subject: [redacted] - EIN: [redacted]
AUDIT CYCLE: TYE's [redacted] & [redacted] - Analysis of [redacted] Debt/Equity ([redacted]) Offering Involving [redacted] and [redacted]

Within the context of assisting the relevant representatives of the Examination Division in regard to the above-captioned large-case examination, this office has been presented with a debt/equity issue arising out of the taxpayer's use of a type of "security" labeled by the taxpayer in the relevant financial documents as a [redacted] ("[redacted]"). We understand that such type of security was the subject of your office's recent November 16, 1998 Private Letter Ruling (hereinafter "PLR") No. 199910046. Based upon our comparison of the facts involved in our immediate scenario with your office's analysis in PLR No. 199910046, we have come to the conclusion that, although factually distinguishable in several relatively minor ways, our present factual scenario is not sufficiently different from that addressed by your office in PLR No. 199910046 so as to justify a different result. We therefore propose to advise the relevant Examination Division representatives that we do not believe that they should attempt to challenge the above taxpayers' treatment of the security involved in the above-captioned case as a debt instrument and not an equity instrument. Because of what we understand to be the sensitivity and the substantial degree of historical National Office involvement in transactions involving security instruments substantially similar to the "[redacted]" instrument involved in the present case, we request your acquiescence and/or input into our above-stated conclusion.

Our analysis of the application to our immediate case of the multiple factors relied upon by your office to determine the debt/equity nature of the security instrument before you in PLR No. 199910046 is as follows:

1. "Unconditional Promise to Pay A Sum Certain on Demand or at a Fixed Maturity Date That is in the Reasonably Forseeable Future" -- Similarly to the factual scenario presented to your office in PLR No. 199910046, the "loans" involved in our present scenario have a fixed obligation to repay the principal amount by a date certain (in our scenario, [redacted] years from the issuance date). As was also the case in the PLR No. 199910046 scenario, the relevant documents in our case contain loan renewal and extension provisions which potentially enabled the borrower to postpone the payment of any loan principal amount for an additional period of [redacted] years provided certain conditions were met. The conditions and limitations controlling the loan renewal and extension provisions in our scenario are virtually identical with those conditions and limitations referred to in PLR No. 199910046 with the exception that the PLR requirement that the borrower have an "investment grade credit rating" is phrased as a [redacted] (by Standard & Poor's) or a [redacted] (by Moody's) credit rating in our scenario. Pursuant to the substantial similarity between our scenario and the PLR No. 199910046 scenario, we believe your conclusion in favor of debt in PLR No. 199910046 on this factor would control our scenario.

2. Right to Enforce the Payment of Principal and Interest -- As was the case in PLR No. 199910046, the actual corporate holder of the loan in our scenario ([redacted]) had certain substantial creditor rights to enforce the loan such as the right to declare the principal and interest on the loan to be due and payable. Also similarly to PLR No. 199910046, the holder of the loan was, in effect, controlled by the lender such that a

colorable argument could presumably be made that any rights given to the holder of the loan were, in reality, meaningless. Finally, similarly to the PLR No. 199910046 scenario, the holders of the relevant [redacted] in the immediate case are given substantial creditors rights to directly enforce the loan agreements between [redacted] and [redacted] on behalf of [redacted]. In reviewing your analysis of this factor in PLR No. 199910046, we see no major factual differences between the PLR No. 199910046 factual scenario and our immediate factual scenario. We therefore believe that your pro debt conclusion in PLR No. 199910046 applies equally to the present scenario.

3. Extent of Subordination of Rights of Holders to Rights of General Creditors -- In PLR 199910046, we note that your office apparently concluded that this factor weighed in favor of debt characterization based primarily upon the facts that, in regard to collection priority, the loans in question were superior to the rights of both the common stockholders of the borrowing company and the general creditors of the borrowing company. Your office's conclusion in regard to the general creditors of the borrowing company was based upon the definition and priority given to "Senior Indebtedness" in the relevant loan documents. Your office's conclusion relied primarily upon the relevant loan documents' definition of "Senior Indebtedness" to specifically exclude unsecured general creditors.

In the above-captioned case, we note

ED: NEED RELEVANT LOAN DOCUMENTS

4. Extent of Right to Participate in Management of Borrower Given to Holders of Security Instruments -- In regard to such debt/equity factor, we note that the relevant documents involved in the present case provide the holders of the relevant securities with the

same limited types of rights as existed in the factual scenario presented to your office in the PLR No. 199910046 scenario. In accordance with your conclusion in PLR No. 199910046, we find that the existence of such limited rights in the immediate case do not indicate that the loans currently before us are equity instruments.

5. The Degree of Thin Capitalization of the Instrument Issuer -- Similarly to the scenario addressed by your office in PLR No. 199910046, the issuer in the present case is not thinly capitalized. In fact, during the period in which the securities in question were issued, the present issuer's debt/equity ratio was an acceptable _____/_____ ratio.

6. Identity between the Holders of the Instruments in Question and the Stockholders of the Issuer -- Similarly to the factual scenario present in PLR No. 199910046, [redacted], the LLC holder of the loans in the immediate case, does not own stock in [redacted], the obligor on the loans. The protections against non-arms length dealing between [redacted] and [redacted] given the holders of the [redacted] in the immediate case are also substantially similar, if not identical, to those protections given the holders of the preferred securities in the PLR No. 199910046 scenario and are therefore apparently adequate to cause such holders to appear to be independent third parties.

7. The Nature of the Labels Placed on the Instruments by the Parties -- Similarly to the factual scenario present in PLR No. 199910046, the present instruments are labeled debt by the relevant corporations, are treated by such corporations as debt for corporate federal income tax purposes and are described by such corporations as debt in relevant SEC and other government filings.

8. The Parties' Debt/Equity Treatment of the Instruments for Non-Tax (including regulatory, rating agency or financial purposes) Purposes -- In PLR No. 199910046, your office focused primarily upon the manner in which the instruments in question were treated both by various financial rating agencies (such as Standard & Poor's and Moody's) and by the involved corporations for financial purposes. Similarly to PLR No. 199910046, we believe the instruments involved in the immediate case would be classified as "equity credit" based upon their unique characteristics. We also believe that your discussion in PLR No. 199910046 of the manner in which the relevant instruments were treated for financial purposes in such scenario would also apply to the scenario confronting us in the above-captioned case.

9. Convertibility of the Instrument into Stock of the Issuer -- Similarly to the PLR No. 199910046 scenario, the instruments in question to do not have a conversion feature.

10. Existence of a Sinking Fund Feature -- Similarly to the PLR No. 199910046 factual scenario, the present scenario involves no sinking fund provisions.

11. Contingent Payments -- Similarly to the PLR No. 199910046 factual scenario, the present scenario involves no contingent payment provisions.

12. Issuer Ability to Borrow from Outside Lending Institutions -- Similarly to PLR No. 199910046, the instrument issuer in the immediate case ([redacted] could have apparently borrowed from outside lending institutions.

13. Issuer Failure to Make Timely Repayments or Seek Appropriate Extensions -- Similarly to

PLR No. 199910046, there is no indication that the instrument issuer in our case has not met this requirement.

In addition to the basic debt/equity issue specifically addressed in immediately preceding subparagraphs 1. through 13., we have also considered the potential application to the immediate situation of the alternative "transaction recharacterization" and "lack of economic substance" issues which your office addressed as Issues 2 and 3 in PLR No. 199910046. For all of the same reasons previously discussed in this memorandum and based upon the applicability to the immediate case of the same reasoning found in your office's discussion of Issues 2 and 3 in PLR No. 199910046, we have concluded that the conclusions reached by your office in PLR No. 199910046 in regard to such issues would apply in the immediate scenario.

For your assistance in reviewing this memorandum, we have included herewith a copy of a [redacted] Prospectus Supplement which describes the factual scenario involved in the immediate case in significant factual detail.

Should you have any questions, concerns and/or objections in regard to this memorandum and/or disagree with our substantive conclusions as discussed herein, please contact John F. Driscoll of this office at (205) 912-5458. Mr. Driscoll is the attorney assigned to this large case examination in this office.

SHUFORD A. TUCKER, JR.
Associate District Counsel

By:

JOHN F. DRISCOLL
Senior Attorney